



MICHIGAN HOUSING COUNCIL

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AUG 03 2007

EXECUTIVE

August 1, 2007

Mr. Michael R. DeVos, Executive Director
Michigan State Housing Development Authority
735 E. Michigan Avenue
Lansing MI 48909

Dear Michael:

Enclosed please find a White Paper on the LIHTC Program prepared by members of the Michigan Housing Council (MHC). The purpose of the Paper is to outline specific industry wide positions and concerns as changes to the Qualified Allocation Plan (QAP) are contemplated. The paper also describes recommended changes to various areas of the LIHTC Program and its administration that our membership, as one of the most active users of the program, sees as critically important improvements at this point in time.

It is our intent to work closely with you and the Authority to devise and implement the best QAP and LIHTC Program that is acceptable to MSHDA, serves the greatest interest of the citizens of Michigan, and is viable to the business community. We hope MSHDA will take under serious consideration industry ideas that, if approved, will promote and achieve cost-efficient, attractive, affordable housing for Michigan residents.

MHC leaders wish to thank you for the opportunity to provide input into the QAP modification process and are available to further discuss the enclosed White Paper. Should you have questions, please do not hesitate to contact me.

Sincerely,

Scott Larry
President

Enclosure

CC: Mary Levine, MSHDA Acting Director of Legal Affairs & LIHTC Program



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White Paper of the Michigan Housing Council¹

Qualified Allocation Plan of the Federal Low Income Housing Tax Credit Program

August 1, 2007

I. Overview

The importance of the Low Income Housing Tax Credit (LIHTC) program and the Qualified Allocation Plan (QAP) to the affordable housing industry cannot be overstated. The LIHTC is the single most important tool we have as an industry to meet an ever growing demand for affordable housing.

At the same time, however, the importance of the housing credit and the QAP to the Michigan economy should not be underestimated. The Joint Center for Housing Studies of Harvard University has estimated that the production of LIHTC units accounts for nearly 26 percent of all new housing units in the Midwest. Given the current economic climate in Michigan, it is likely that the production of LIHTC units in Michigan accounts for an even larger share of the market than the Harvard estimate indicates. The new QAP will have a profound impact - positive or negative - on the Michigan economy in the next 12 to 36 months.

II. Core Policy Assumptions

Since the inception of the program, five core policy assumptions have guided the LIHTC program and the development of the QAP in the State of Michigan. These assumptions are time-tested and have a proven track record for delivering deeply targeted rental units into the Michigan marketplace while creating badly needed jobs and expanding the tax base in local communities. These

¹ The Michigan Housing Council is one of the oldest statewide associations of affordable housing professionals in the United States and represents owners, developers, managers, general contractors and subcontractors, architects, engineers, attorneys, financial groups, lenders, insurers, accountants, market analysts, tax credit syndicators, and other consultants, non-profits and businesses involved with Michigan's affordable housing industry.

assumptions must be maintained by MSHDA if it is to preserve the entrepreneurial spirit that has made the Michigan LIHTC program and the Michigan QAP national models.

1. Consistency.

In historical terms, changes to the Michigan QAP have been measured and incremental. Sweeping changes to the QAP have been rare, and even in those instances, such changes were phased in over time to accommodate the complexities of the development process. Although we believe changes to the current QAP are necessary, we do not believe, as some have suggested, that the current QAP must be substantially re-written. The groundwork for sweeping changes to the QAP has not been laid, no data been presented that would justify such an action, and there was no public support for sweeping changes to the QAP in any of the four listening sessions conducted by MSHDA. Rather, many of those who attended the MSHDA public forums agreed with the observation of the Community Economic Development Association of Michigan that "any wholesale changes to the QAP will disrupt the complex process of planning for affordable housing in communities."²

Consistency of the QAP from year-to-year has been the strength of the LIHTC program in Michigan. It has fostered a stable environment in which affordable housing practitioners are able to plan and develop affordable housing. It has delivered tens of thousands of affordable rental units to the Michigan marketplace, and it has provided a living wage to thousands of Michigan workers.

In our opinion, consistency must not be sacrificed in a rush to develop and approve a new QAP.

2. Flexibility.

More than any other program administered by the MSHDA, the LIHTC program and the QAP rely on market forces - rather than administrative fiat - to guide and shape the development process and the allocation of the housing credit. Historically, MSHDA has limited its role to three activities - determining the financial viability of the proposed project, reviewing the rental market for the proposed development, and assuring that any environmental issues associated with the proposed development will be addressed. Project sponsors have been encouraged through the use of points and other incentives to deliver certain types of housing that meet particular housing needs. In the end, however, the type housing to be built is determined by local market conditions and local need.

² Public Statement of the Community Economic Development Association of Michigan before the Michigan State Housing Development Authority dated May 18, 2007.

Although we believe changes to the financial, market and environmental reviews are necessary, the reliance on market forces, points and other incentives to guide and shape the development process must be maintained as a core policy assumption of any new QAP.

3. Deep Targeting.

In exchange for greater flexibility and less administrative oversight of the development process, the QAP has encouraged - and market forces have demanded - that priority be given to projects that serve the lowest income households for the longest period of time. How deeply LIHTC rental units may be targeted is a matter of simple economics - income from the rents to be charged has to be greater than or equal to the expenses of the project to be developed. MHC recognizes and supports helping those most in need. We also understand, however, that without additional state or federal resources like Medicaid waivers or project-based vouchers or even the proposed and unfunded Housing and Community Development Fund, there are practical limits on how deeply LIHTC units may be targeted.

Historically, the QAP has recognized this dynamic and relied on the creativity of the private sector to structure transactions that serve the lowest income households possible within the financial constraints of available resources to a particular project. The result has been truly remarkable. LIHTC developments are more deeply targeted and serve lower income households than similar developments in MSHDA's direct lending pipeline or the MSHDA portfolio despite the fact that MSHDA has access to substantial reserves and federal resources like the HOME program or project based Section 8 vouchers.

Although we support assisting households with the greatest need, we believe imposing further targeting requirements without the benefit of additional public resources is not justified and would be counter productive. We also believe that the core policy assumption to rely on points and other incentives - rather than on unfunded public mandates - to encourage private sector creativity to deeply target LIHTC developments must be maintained as a core policy assumption of any new QAP.

4. Fairness.

The allocation process must be fair to all applicants and all types of housing production. Demand for the LIHTC continues to rise. Projects from all over the state must compete head-to-head, and each project and every project sponsor believes that his or her project represents the highest and best use of a scarce public resource.

Excess demand for the housing credit is not new. In fact, the LIHTC has been oversubscribed since the early 1990s. Despite this fact, Michigan is one of the few states in the country that has not been sued for its administration of the LIHTC program because, successful or not, participants believe that the process of reviewing and awarding the housing credit has been fair and impartial.

Although we believe changes to the allocation process are desirable, we also believe that fairness and impartiality must be maintained as a core policy assumption of any new QAP.

5. Adequate Staffing.

Processing 200 to 250 tax credit applications annually – in addition to the other administrative tasks required by the program - requires a dedicated and competent staff. Historically, MSHDA has devoted the resources necessary to assure that tax credit applications and other administrative matters are processed quickly and efficiently.

In the past two years, however, MSHDA has created and fully staffed new administrative divisions responsible for economic development, urban development, supportive housing, and outreach to southeast Michigan and has added staff positions to nearly every program area but the low income housing tax credit program. In fact, the number of MSHDA employees increased by 25 percent – or 60 employees - in the past two and half years while the salary line item of the MSHDA budget swelled by over 55 percent during the same period³.

Unfortunately, resources for administration of the LIHTC program have not kept pace. One of the four tax credit analyst positions has been vacant since December of 2006 and despite repeated requests from Senior Management for additional support, MSHDA still has only one Environmental Review Officer to review the hundreds of tax credit applications it receives.

Although we do not question the need for such new divisions to the extent the fees generated by their activities are sufficient to support their administrative costs, we are concerned that MSHDA staff resources are not being devoted to this vital LIHTC program area. Adequate staffing levels for the LIHTC program must be maintained as a core policy assumption to support any new QAP.

³ Data for 2005 and 2006 is taken from the Audited Financial Statements of the Michigan State Housing Development. Data for 2007 and 2008 is taken from the MSHDA budget approved June 27, 2007.

III. Industry Recommendations

We have surveyed our members and identified a number of broad recommendations for your consideration for inclusion into the QAP. These include:

- **Two Annual Funding Rounds.**

It is absolutely critical that there be two tax credit funding rounds in 2007 and a minimum of two funding rounds during any year governed by the new QAP.

At a seasonally adjusted rate of 7.2 percent, Michigan's unemployment rate is the highest in the country, and construction employment is down 25,000 jobs from just a few years ago according to a recent editorial in the *Detroit News*⁴. Michigan needs jobs, and the public benefit of the housing credit is not limited to the rental units created by the program. The public benefit of the housing credit also lies in the jobs created, the increased demand on local services and retailers, and an expanded tax base for local communities as LIHTC developments come online.

As we stated in our prepared remarks at each of MSHDA's informational forums and in our letters to MSHDA Executive Director Michael DeVos dated July 11, 2007 and July 19, 2007, we remain deeply concerned with any proposal to delay the next tax credit funding round until a new Qualified Allocation Plan (QAP) has been adopted.

We see no public good coming from a decision that will delay a second tax credit funding round this year resulting in a delay of the economic benefits of the LIHTC program to the State of Michigan and its citizens. Nor do we believe, given federal requirements and practical limitations outlined in our letters, that it will possible or advisable to hold a tax credit funding round under a new QAP this year. Under the best of circumstances, it would be an optimistic scenario to have a second funding round in 2007 under a new QAP; rather, it is likely that the initial draft of the QAP will require further discussion and revision before it is approved.

Holding an October funding round hostage to the approval of the next QAP is by default a decision to delay the economic activity associated with these developments for a year or more. Holding an October funding round hostage to the approval of the next QAP is by default also a decision to deny Michigan projects an opportunity to compete for Affordable Housing Program Funds of over \$4 million from the Federal Home Loan Bank of Indianapolis, as well as funds from other Federal Home Loan Banks. The result will be to push those resources to other states and other areas serviced by the member banks. There are plenty

⁴ Editorial, The Detroit News, July 11, 2007.

of developments in the pipeline, and if we are to maximize and capture the true economic value of the LIHTC program at a time when our state needs it the most, there must be a second tax credit funding round in 2007 under the current QAP and a minimum of two funding rounds in any future year governed by the new QAP.

A recent editorial in the *Lansing State Journal* said it best.⁵ "Michigan is in no position to let jobs slip away." We agree.

- **Increase Acquisition and Rehabilitation Incentives.**

Acquisition and rehabilitation projects are becoming an increasingly large part of the affordable housing portfolio in Michigan. In 1995, less than 15 percent of all the tax credit units placed in service in Michigan were in acquisition and rehabilitation projects. Today, that percentage has more than tripled, and over 50 percent of all tax credit units placed in service on an annual basis are located in acquisition and rehabilitation projects.

The shift from new construction to acquisition and rehabilitation projects is due, in part, to the preservation and smart growth incentives that are part of the current QAP. The shift also reflects current economic conditions including soft rental markets in nearly all of the state and the reluctance of tax credit investors to fund the creation of newly constructed units in soft rental markets.

Although new construction may be a viable option in a limited number of communities - given what we know about the real estate market today and what we can see into the future - we believe that the current incentives in the QAP for preservation and other acquisition and rehab developments not only need to be maintained - they must be expanded, and the current preservation holdback must be increased to 40 percent of the MSHDA's annual credit ceiling.

- **Create a Low Income Housing Tax Division within MSHDA.**

A recent article in the Michigan Privatization Report states that last year MSHDA devoted "considerable resources to projects that have little to do with low income housing. Instead, the agency seems more and more interested in getting into the game of economic incentives."⁶ The article continues that "there are four divisions within MSHDA that can be considered part of the economic development scheme. The 67 employees working in these divisions cost MSHDA \$5.2 million annually." At the same time, while no new financial incentives have been provided

⁵ Editorial, *The Lansing State Journal*, July 12, 2007.

⁶ Michigan Privatization Report, Mackinaw Center for Public Policy, Summer 2007.

for MSHDA's direct lending programs, funding for Grants and Subsidies in other areas of MSHDA has increased by 103 percent.⁷

If true, four divisions and 67 employees for economic development activity versus no division status and five MSHDA staff dedicated to the administration of LIHTC program seems grossly disproportionate given the importance of the LIHTC program in developing affordable housing and creating construction related jobs.

If true, MSHDA must review its current spending priorities against its legislative mandate. MSHDA must also provide the necessary resources to adequately staff and administer the LIHTC program, and recognize the importance of the LIHTC program by creating a new division on a par with four divisions dedicated to economic development.

- **Maintain Current Special Needs Set-Aside.**

MHC recognizes and supports helping those most in need.

We understand, however, that without additional public resources like Medicaid waivers or project-based vouchers or even the unfunded Housing and Community Development Fund, there are practical limits on how deeply LIHTC units may be targeted or the kind of services to be provided. In fact, a recent study⁸ by the National Association of Homebuilders (NAHB) suggests that current LIHTC developments are under financial distress due to a prolonged period of stagnant income limits and rents. The NAHB study also states that "property owners, syndicators, or HFAs will need to find additional subsidies for projects, or risk losing them from the affordable housing stock. Possible sources of additional subsidies are finite." Unfortunately, we have also seen that the limited public resources for services and operations are not without risk and – if available – are often short-term commitments when compared to the financial commitment of a 30 or 35 year mortgage.

Supportive housing incentives have been incorporated into nearly every QAP for the last seven to ten years - including a requirement that every LIHTC development maintain units for extremely low-income households that was abandoned by MSHDA in 2005 because of concerns regarding the financial burden such a requirement placed on LIHTC developments. Yet, no information exists and no studies have been conducted by MSHDA to confirm the impact that these units have had or to confirm that the required services are reaching the tenants.

⁷ Data for 2005 and 2006 is taken from the Audited Financial Statements of the Michigan State Housing Development. Data for 2007 and 2008 is taken from the MSHDA budget approved June 27, 2007.

⁸ HUD's New Income Estimates Endanger Viability of Affordable Rentals, National Association of Home Builders, 2007.

Prior to proposing any increase in the special needs holdback, we believe that tangible, long term financial commitments to fund services must be identified and that MSHDA must undertake an independent third party review to evaluate these units and determine what lessons can be learned from the supportive housing units that have already been placed in service.

- **Maintain Geographic Caps.**

In 2005, MSHDA instituted a policy that no more than 45% of the credit reserved under any holdback or the general funding round will be allocated to projects located within a single city, village, or township. As a matter of simple fairness and to assure that every community – including communities in West Michigan - has an opportunity to receive credits, we supported this policy in 2005 and we believe that the current policy must be maintained in the next QAP.

- **Processing Time.**

In the last year, the time required for processing tax credit applications has increased from ten weeks to several months or longer. Although we understand the demands on staff in processing the large number of tax credit applications received by MSHDA, we also understand that the number of applications received by MSHDA is not unusual for a state as large and diverse as Michigan with approximately \$19 million of housing credits to administer annually. States like Michigan - both in terms of the size of their programs and the demand on their resources - process tax credit applications on average within 60 days from the receipt of the application. The Michigan experience is quite different. The – second 2006 tax credit round stretched out for six months with applications accepted on September 15, 2006 and final awards announced on March 15, 2007. Even states that use a lottery as part of the allocation process like Michigan are able to process applications within a 60 day timeframe.

Delay is an economic cost to a project and its sponsor, but it is the tenants of the proposed development who will shoulder the burden of additional costs through higher rents. The new QAP must commit to processing applications in a timely and efficient manner with the entire process – start to finish - taking no more than 60 days. If other states with the same or greater volume of requests as MSHDA can complete their review in 60 days, MSDHA should be able to meet that timeframe as well.

- **Environmental and Marketing Pre-Reviews.**

We appreciate the opportunity to work with MSHDA's Environmental Officer and marketing staff to review in advance materials required to be included with a tax credit application. A pre-review in each of these areas gives everyone in the process an equal opportunity to identify MSHDA concerns long before an application is submitted for review. In our opinion, however, the current process must be changed to provide certainty and concrete answers to the underlying questions posed by each tax credit application - is there a market for the development and is the environmental review of the proposed development acceptable to MSHDA? The current pre-review process does not provide answers to those questions. To the contrary, it is quite possible to go through the pre-review process only to be rejected in the tax credit round for marketing or environmental issues.

In our opinion, the time and expense of a market study or an environmental review more than justify greater certainty in the pre-review process. Once a project has been pre-reviewed by MSHDA staff, its sponsor should know the answers to those two questions, and should be able to rely on those answers throughout the allocation process.

We also believe that greater certainty on the front end of the allocation process will decrease the processing time on the back end of the process. In the second cycle of 2006, applications were due on September 15, 2006 and the MSHDA lottery was held in the early November. But final market and environmental reviews started only after the lottery - pushing the final award announcements to March 15, 2007. If the market and environmental reviews had been completed earlier in the process as we are suggesting, we believe final awards would have been made shortly after the lottery.

- **Cure Period for Minor Errors.**

In every funding round, there are examples of projects that are denied points, or even credits, because of simple clerical or administrative errors on the part of the applicant. It's inevitable that somewhere - in the hundreds of pages contained in each application - something is going to be overlooked. Often, however, the penalty for such an error seems disproportionate when points are denied or - even worse - when projects are rejected for further consideration. This situation is not unique to Michigan.

Other state allocating agencies, however, have provided applicants with an opportunity to correct such mistakes as part of the allocation process without penalty to the underlying application. We believe the new QAP must provide an opportunity for project sponsors to cure minor, technical

errors, and that after nearly 20 years program experience and processing tax credit applications MSHDA should be able to identify the circumstances under which such changes may be allowed to a pending application.

- **Re-evaluate Rent Matrix.**

Although the rent matrix accomplishes the goal of producing deeply targeted rental units, it is overly complicated and is based on a less-than-optimal formula. Based on numerous examples in other state QAPs, deep rent skewing can be effectively achieved using simpler and more straightforward methods.

IV. MSHDA's Priorities Are Missing.

Throughout the public hearing process, one voice has been missing from the process – the voice of MSHDA. Although it is vitally important for MSHDA to hear the concerns of affordable housing practitioners, it is critically important for affordable housing practitioners to hear from MSHDA; to understand what, if any, changes MSHDA believes may be necessary; and to understand the policy assumptions or data that support such changes. This is not a new concern. In fact, changes were made to the current QAP on the assumption that future informational forums would include presentations from MSHDA staff on these matters but that has not happened. Rather, MSHDA staff has indicated that it would take the information from the public forums - along with staff recommendations – and develop a new QAP.

MSHDA staff has also provided public assurances throughout the forums that no decisions regarding the new QAP had or would be made until the informational process was complete. Sadly, this has proved not to be true. In May of this year, MSHDA released an internal memo dated May 17, 2007, recommending sweeping changes to its direct lending programs and introducing a significant new policy direction for the allocation of housing credit in the State of Michigan. Unfortunately, at no time during the last ten weeks have we - or any other participant in the forums - heard what those recommendations may be, how such recommendations will respond to the concerns expressed in these forums, or if the recommendations will take the QAP in an entirely new direction.

The LIHTC program and the QAP are far too important to the affordable housing industry, MSHDA, and the state of Michigan not to have a full and open discussion from all interested parties regarding these matters in this type of a setting rather than in the context of a 30-day public comment period. We strongly recommend that prior to the initiation of any public comment period, MSHDA hold another series of forums so that we can hear from MSHDA staff and understand the reasons and the policy assumptions for the changes that staff will be suggesting.